

MAY 14, 1984

\$3.00

FORTUNE

HOW TO SNOOP ON YOUR COMPETITORS

AN HONORABLE MANAGER'S GUIDE



BLACK & DECKER'S
GAMBLE ON
"GLOBALIZATION"

THE SALARY
STRAITJACKET
CALLED
COMPARABLE
WORTH

CRACKS IN
THE JAPANESE
WORK ETHIC

*****5-DIGIT 20814
MAY88 000 ES/20099V 52 08 14
CONGRS ENL INFO SVC MD30
4520 EAST-UEST HWY
STE 300
BETHESDA MD 20814



Snooping on competitors has become commonplace. In his cover painting, Leslie Cabarga used a keyhole and a peeping executive to symbolize the dubious new vogue. The reasons for snooping, and the methods, are examined on page 28.

MANAGING

How to Snoop on Your Competitors 28

Most of the techniques are legal. Some are even ethical. *by Steven Flax*

THE ECONOMY

Fortune Forecast: ■ Slower Growth Will Cool the Fevers 36

■ Shaping Up Inventories 37

CORPORATE PERFORMANCE

Black & Decker's Gamble on "Globalization" 40

Having bought GE's small-appliance business, the toolmaker is preparing a new strategy. *by Bill Saporito*

A Makeup Maker's Fast, Foxy Rise 51

L'Oréal of France has sashayed ahead of Revlon. *by Shawn Tully*

SELLING

More Power to the PC Chains 83

As the big computer retailers grow, smaller stores and manufacturers suffer. *by Joel Dreyfuss*

Color Clash of the Appliance Titans 92

Knocked from Third Place, 7 Up Is Going Flat 96

TECHNOLOGY

The Latest Word in Show and Tell 101

An inexpensive alternative to the corporate slide show. *by Bro Uttal*

Inmos: A Chip with a Mind of Its Own 114

MONEY & MARKETS

The Revolution in London's Financial Markets 118

British and American firms are rushing into combat. *by John W. Dizard*

Shearson Bites Off a Mouthful with Lehman 129

Manville: How to Milk a Bankrupt 130

POLITICS & POLICY

"Pay Equity" Is a Bad Idea 133

It would put compensation in a strait-jacket. *by Daniel Seligman*

This Weapon Will Work or I'll Fix It Free 143

Insider Crackdown 143

Why Business Won't Follow Reagan to China 144

PROFILE

Jerry Tsai Seems Bound for Glory—Again 154

He's redeeming his reputation at American Can. *by Arthur M. Louis*

People to Watch 160

LOOKING AHEAD

Cracks in the Japanese Work Ethic 162

That old do-or-die for company and country is fading. *by Lee Smith*

Japan Takes a Swing at Leisure 170

The "mai generation" is emulating America's skill at making the most of its off hours. (*A picture portfolio*)

The Editor's Desk 4

News/Trends 6

Auto satisfaction, the sum of Ma Bell's parts, Levittown revisited, traders take over, Ace Satellite Repair, Freddie Laker II, TV role reversals, and more.

Letters to Fortune 13

Keeping Up 179

by Daniel Seligman

Follow-Up 183

Harvard's new ethics, bottoms up at Esmark, Shamrock courts Dorsey, and more.

Personal Investing 193

Food stocks. Municipal bond funds. Hospitals. Portfolio Talk: fund manager Michael Price. *by Elizabeth S. Silverman*

On Your Own Time 209

Executive Olympic hopefuls. *by Marilyn Wellemeier*

Books & Ideas 221

A tax cutter's sad tale. *by Melvyn Krauss*

SELLING

MORE POWER TO THE PC CHAINS

The big personal computer retailers are getting bigger fast. That's terrible news for small computer retailers—and for the scores of manufacturers whose machines aren't proven winners.

■ by Joel Dreyfuss

AS SOON as personal computers were created, computer stores popped up to sell them. As the personal computer market boomed, the computer retailers flourished. And now, just when it looks as if big manufacturers are beginning to dominate the personal computer business, bigness is becoming the byword in retailing. "To be successful," says David Norman, founder of Businessland, a 28-store

chain based in San Jose, California, "you have to be large."

The heady expansion of the market has showered prosperity, or at least the promise of it, over the hundreds of personal computer makers and the thousands of computer retailers that have sprung up in less than a decade. But it has also helped produce a curious situation: the manufacturers of less popular PCs are almost utterly dependent on the smaller re-

tailers—who in turn are dependent on them. Lacking size and therefore clout, small store owners often can't get the best-selling brands, whose manufacturers can afford to be choosy. The dependence of the two weak reeds upon each other will eventually lead to their more-or-less simultaneous demise.

Computer stores will peddle almost half of the \$12 billion of personal computers that will be sold this year, ac-



Mirror reflections catch the heavy lunchtime traffic at a ComputerLand store in midtown Manhattan, one of the busiest franchisees in the 509-store chain.

SELLING

William Millard first founded IMS Associates, which in 1976 launched the IMSAI-8080, one of the early microcomputers—it came in a kit. But Millard got so many requests for dealerships that he started ComputerLand, a chain of franchisees with sales last year of around \$1 billion. The founder-chairman and his family own over 95% of the company.



cording to Future Computing, a Richardson, Texas, research company. The other half will be sold mainly in department stores, by mail order, or by computer manufacturers selling to businesses direct. By 1988, when personal computer sales could top \$30 billion, industry forecasters predict computer stores will number 6,900, up from 4,000 at the end of this year. After 1988 the growth of outlets is likely to slow. "The window is not going to be open too long," says Norman. William Ladin Jr., chairman of ComputerCraft, a Texas-based chain of 32 stores, predicts, "In a few years there will be five to ten major retailing chains."

On the theory that only the biggest will survive, retailers are expanding furiously. ComputerLand, the second-

RESEARCH ASSOCIATE *Daniel P. Wiener*

largest chain after Tandy, has 509 U.S. stores under franchise now and expects to have 750 by the end of the year. Privately held, the chain predicts its stores' 1984 sales will be almost \$2 billion, double last year's. Entré Computer Centers, based in Vienna, Virginia, had sales of \$48 million in its fiscal year, which ended last August. In fiscal 1984, it expects sales to quadruple to \$210 million, as its franchisees expand from 150 to 250 by year-end. IBM, which has 79 company-owned IBM Product Centers, is opening new ones at the rate of one a week. More than a half dozen companies, including Entré and Businessland, have gone public in the last 12 months to raise capital to open additional stores or buy up mom and pop computer stores.

The concentration of retail power

will leave computer makers with fewer avenues to the consumer. There are precious few now. Though 200 manufacturers offer some 400 different models, most retailers limit their inventory to around five computer lines. For one thing, the dealers' salespeople have to understand and demonstrate each model they sell. "It's the span-of-knowledge problem," explains Richard Matlack, president of InfoCorp, a Cupertino, California, market researcher. For another, the retailer may lack shelf space for dozens of different computers and the peripheral equipment and software that go with them.

INFOCORP ESTIMATES that IBM and Apple hold 45% of the personal computer market between them. Future Computing figures that Compaq, DEC, Kaypro, Texas Instruments, and Epson round out the list of best-selling computers carried by computer stores. Invariably, the big chains offer the top sellers—this, in turn, boosts the big brands' cachet. "When a computer is sold by a major retailer," says William Campbell, vice president of marketing and sales for Apple Computer, "it is enhanced in the eye of the consumer." No such halo effect surrounds computers sold in small stores without attachments to a larger chain. But most computer manufacturers—those outside the big-brand club—must rely on such stores anyway, since that is often their only way of getting products to the consumer.

Yet minor stores handling minor products seem doomed. World Of Computers, a Denver-based company, is making a good business of converting mom and pop stores into company franchisees—and not by buying the independents out. The small stores are so anxious to become part of a chain, and thereby gain access to a top line of products, that they willingly plunk down a \$25,000 franchise fee. The price tag is cheap by comparison with what it costs to hang out a ComputerLand sign: \$75,000.

Byte Industries, a Hayward, California, chain that started franchising in 1982, recently sold MicroAge Computer Stores the right to sign up all 22 Byte Shops. The shops had an okay line of computers—they sold

SELLING

Franklin, Eagle, Kaypro, and Epson brands. But, says Robert Miller, Byte executive vice president, "The main problem was that we could not get leading products. We couldn't get an agreement with IBM." MicroAge is a 54-store Arizona-based chain whose principal owner is Olivetti, the Italian office equipment company. It handles a broad line of computers, including IBM.

Everything seems to favor the big guys. "The economics of running a single store don't compare with running a chain," says Esther Dyson, president of EDventure Holdings, publisher of a computer industry newsletter. Chains enjoy economies of scale in advertising, distribution, and training. Even more important, they can get better prices on their products from the manufacturers. Small independents usually buy at 75% of list price while large chains often pay only 60% to 65%. Many industry analysts predict that the present shortages of the more popular brands will disappear and discounting will spread. When that happens, the mom and pops will be hard pressed to make money. To escape the margin squeeze, more and more small independents will be willing to fork over the franchise fees.

While most of the big chains are franchise operations, those owned by manufacturers—IBM's Product Centers and Tandy's Radio Shacks, for example—don't offer franchises. Nor do some of the new computer store chains such as Businessland. The company-owned chains argue that when it comes to customer service, they have the edge over their franchising competitors. The franchisers argue just the opposite. But both agree that service is the computer retailers' primary marketing tool—though that may strain the credibility of anyone who has been either intimidated by a salesperson spouting computerspeak or appalled at how little the help seemed to know.

THE RETAILERS' mantra seems to be: we're not selling computers, we're selling solutions to problems. Both franchised and company-owned stores assure their customers that they stand ready to do as much handholding as necessary—from sending a sales representative directly to the customer to installing the computer, training the user, and answering questions at all hours about the machine's mysterious workings. All the handholding is obviously far too

expensive for a small independent to even consider.

ComputerLand and Entré contend that their extensive training requirements—ComputerLand store owners must undergo a month of training—guarantee consistent service. They insist that a franchisee will work harder than a corporate employee to satisfy customers. As Steve Heller, executive vice president of Entré, argues, "a franchisee has a house, a car, and the store on the line."

Retailers with company-owned stores counter that franchisers cannot control service and guarantee dependability in a far-flung empire of fiercely independent entrepreneurs. Norman of Businessland claims that a company-owned chain can attract better employees, and keep them longer, than the manager of a franchised store, by offering a corporate career ladder to climb. Businessland salespeople average \$50,000 a year in salary and commissions; top performers earn over \$100,000.

Some retailers use a straddle strategy and have both franchisees and company-owned stores. Valmont Industries of Valley, Nebraska, one of the largest manufacturers of specialized irrigation equipment in the world, found that its farmer-customers were intrigued by the computers it used in its business. In 1982 Valmont began selling IBM computers to farmers and soon discovered a market of lawyers, doctors, and accountants in rural America. The company now has 50 company-owned stores and 72 franchisees.

IF SIZE AND SERVICE turn out to be the keys to successful computer retailing, consider the threat IBM poses for the other retailers. IBM not only makes the most popular office computer, the IBM PC (as well as the not-so-well-loved PCjr), it also distributes a lot of them through that ever enlarging chain of IBM Product Centers and through its own corporate sales force. At many of the 1,400 other computer dealers lucky enough to carry them, IBM PCs are the biggest-grossing product. William Millard, founder, chairman, and principal owner of ComputerLand, says IBM is not prone to "infantile or inappropriate be-

The Top Ten Chains

At the end of March, ten computer retailers had 50 or more U.S. outlets, but most concentrated on a narrow line of products.

STORE NAME PARENT COMPANY	NUMBER OF STORES		PRINCIPAL COMPUTER BRANDS SOLD
	Company owned	Franchised	
RADIO SHACK COMPUTER CENTER Tandy Corp.	1,114*	0	Tandy/Radio Shack
COMPUTERLAND ComputerLand Corp.	0	509	Compaq, DEC, IBM, Texas Instruments
ENTRE COMPUTER CENTERS Entré Computer Centers Inc.	1	150	Compaq, DEC, Grid, IBM, TeleVideo
VALCOM COMPUTER CENTER Valmont Industries Inc.	50	72	Compaq, IBM
TEAM ELECTRONICS Team Central Inc.	9	83	Apple, Columbia
IBM PRODUCT CENTER IBM Corp.	79	0	IBM
CONTROL DATA BUSINESS CENTER Control Data Corp.	55	0	Hewlett-Packard, Wang, Zenith
MICROAGE COMPUTER STORES MicroAge Computer Stores Inc.	1	53	Altos, Apple, Compaq, Corona, DEC, Hewlett-Packard, IBM, TeleVideo
DIGITAL BUSINESS CENTER Digital Equipment Corp.	52	0	DEC
SEARS BUSINESS SYSTEMS CENTER Sears Roebuck & Co.	50	0	Compaq, IBM

*Including 682 Radio Shack electronics stores that sell a full line of Tandy computers.



With \$50 million in capital, Businessland founders David Norman (left), formerly head of Dataquest, a Silicon Valley research firm, and Enzo Torresi, a former Olivetti executive, aim to expand from 28 stores to 80 by the end of the year. Businessland averages \$5 million in annual sales per store vs. ComputerLand's \$2 million.

havior." But Millard and others acknowledge that IBM could end up favoring its own sales force or retail stores with special prices, products, or promotions. Says Millard, "We all want to be No. 1 and we're working hard so we won't be slave to another No. 1."

Perhaps for that reason, ComputerLand is putting the finishing touches on an agreement to sell Apple computers. The big retailer buys computers in huge volumes and then sells them at its cost to its franchisees—in return for 8% of the retail gross. ComputerLand had bought Apple IIs for its stores until July 1982, when it split with Apple because the computer maker wanted the right to approve new ComputerLand locations. Apple was seeking to protect its existing dealers, generally small independent retailers of the mom and pop variety. When ComputerLand refused to go along, Apple stopped supplying its products to ComputerLand—though it continued to sell direct to some ComputerLand franchisees. The new agreement between Apple and ComputerLand apparently doesn't give Apple any say about where ComputerLand's stores can be located.

As chains have become more powerful, manufacturers are increasingly having to demonstrate that their prod-

ucts will sell even *before* the chains will accept them. Yet, as a man who owned one of the first ComputerLand franchises notes, "It's a chicken-and-egg sort of thing. What retailers carry determines what gets sold." Entré reports receiving audiocassette presentations from several small manufacturers pleading for shelf space. Some vendors put their products in stores without payment for up to 90 days to try to convince dealers that they will sell.

EVEN APPLE has had to struggle. It tried vainly to get Businessland to carry its Apple II line; the retailer judged it too much a home computer for its exclusively business clientele. After Apple mounted its \$50-million product introduction for the Macintosh, a more powerful machine with sophisticated computer graphics, Apple and Businessland came to terms.

When Compaq introduced the first IBM-compatible transportable computer, now a proven success, Entré waited about six months to see if the product would sell before taking it on. "Everyone wants to sort out the winners," says Entré's Heller. "We don't have to make that guess. We just wait and see."

TeleVideo Systems took an indirect

route to get into the chains. Because TeleVideo was an industry leader in the production of computer terminals before it introduced its personal computer line last year, the company chose to market the computers through the distributors who had been selling its other products. Backed by a \$20-million ad campaign, the distributors sold the line well enough to attract the chains' attention. Entré and ComputerLand picked it up at the beginning of this year. "Most companies try to get into the big chains first," says Frank Zurcher, executive vice president of TeleVideo. "That's dangerous because [from the retailer's point of view] you're either hot or you're not."

MINDSET CORP., a well-financed start-up, learned that lesson early this year when it introduced a new IBM-compatible computer with powerful graphics capabilities. Though the computer got favorable reviews and extensive coverage in computer magazines, Mindset had trouble lining up a retail distribution agreement. Mindset President Roger Badertscher insists that he will succeed in gaining access to top-tier distributors. But he concedes, "There's no question that the retail channel has a lot of products, and shelf space is an issue."

In the long run, computer makers could develop machines so easy to use, and to sell without special handling, that they could be marketed almost anywhere, like calculators. But in the meantime, the narrowing of the retail channels is likely to bring on that much-discussed shakeout of personal computer makers that has so far failed to materialize. And as the weaker manufacturers fall by the wayside, so will the smaller retail chains.

With the industry's sales predicted to grow at more than 30% a year over the next few years, though, the survivors will prosper mightily. Millard of ComputerLand describes the computer-retailing industry today as "a pressure cooker. Everything is in turmoil." But Millard, who intends to be one of the survivors, certainly isn't fretting: "Everyone knows the market has an incredibly bright future." And it's brightest for the biggest. **□**

yield muni funds, a fast-growing species that concentrates on lower-grade bonds. Peter Gordon, executive vice president of T. Rowe Price, favors a prudent compromise. He advocates putting about 30% of your money in long-term funds, 40% in intermediate funds, and 30% in short-term funds as a kind of cash reserve. If you think interest rates are heading down, you can always trade in short-term shares for long.

Hospital Stocks: The Vital Signs Are Good

■ Anxieties over the government's tight-fisted new policy on Medicare reimbursement, as well as other worries, have landed hospital stocks in the emergency ward. After a decade in which companies that run hospital chains for profit were market superstars, prices tumbled 27% in the latter half of 1983.

Now the stocks look hardy again; they've held their own this year as the indexes sank. They may even be underpriced, with many selling at 12 times projected 1984 earnings. That's too low, say most Wall Street analysts, for companies whose profits are expected to grow by at least 20% annually over the next several years.

Hospitals can no longer count on Medicare, typically the source of about half their revenues, to pick up all the expenses of an elderly patient's stay. Under new rules being phased in over three years beginning last October 1, the federal government will pay a flat sum for treating a particular illness, regardless of a hospital's costs. Inefficient hospitals could lose a bundle.

The new rules hit at a time when occupancy is down at many hospitals. Some employers, anxious to rein in their health insurance costs, are requiring employees to chip in more for medical services. As a result, many would-be patients are passing up elective surgery and other procedures normally done in hospitals. Other patients are turning to lower-priced alternatives, such as free-standing surgical centers that run on an outpatient basis. "The cost of hospital care is so great," says David Lothson of Paine Webber, "that it is influencing private consumption dramatically." So dramatically, in fact, that he's not generally recommending hospital stocks.

Most analysts are bullish, though. David Talbot of Drexel Burnham Lambert says hospital stock prices don't reflect the companies' prospective earnings growth over the

COMPANY	REVENUES in millions Fiscal year-end	NET INCOME in millions	STOCK PRICE RANGE last 12 months	RECENT PRICE P/E multiple ¹
Hospital Corp. of America	\$3,203.0 12/31/83	\$243.2	\$35.375— \$56.625	\$38 11
Humana	\$1,765.1 8/31/83	\$160.6	\$19.50— \$33.25	\$23.75 12
National Medical Enterprises	\$1,765.0 5/31/83	\$93.0	\$18.875— \$32.375	\$19.125 11
American Medical International	\$1,339.6 8/31/83	\$101.5	\$20.625— \$37.25	\$24.125 12
Charter Medical	\$358.7 9/30/83	\$26.9	\$17.50— \$30.125	\$21.25 13
Community Psychiatric Centers	\$138.2 11/30/83	\$26.9	\$25.375— \$45.50	\$29.25 17

¹Based on earnings estimate for current fiscal year compiled by the Institutional Brokers Estimate System.

Hot Stocks That Cooled

Their share prices may be down, but earnings go right on climbing at these hospital companies. None has suffered an earnings-per-share decline for at least eight years.

next few years and their ability to adapt to the new reimbursement rules. Because of tight cost controls and better management, most Wall Streeters say, hospitals that are run for profit can survive better in the new climate than nonprofit institutions. The hospital companies have also been expanding into services, such as surgical and convalescent centers, that should be in bigger demand as hospital usage falls.

Nashville-based **Hospital Corp. of America**, the largest company in the industry, and **American Medical International**, headquartered in Beverly Hills, are favorites of Kenneth Abramowitz of Sanford C. Bernstein. Both own lots of hospitals in one-hospital towns, or in small cities where theirs is the dominant facility, and both have other products in their medicine chests.

A POTENTIAL MENACE to hospital chains is the rise of health maintenance organizations (HMOs), which offer across-the-board medical services—outpatient and hospital care—at flat "subscription" rates. With a built-in incentive to avoid excessive treatment, the increasingly popular HMOs have reduced hospital stays. So far, most hospital companies haven't operated in locales with HMO competition.

Meanwhile, most of the large chains have moved boldly to attract more patients. They're testing so-called preferred provider organizations (PPOs)—insurance programs that offer financial incentives to use the chain's own hospitals rather than others. The company doing it just right, says Talbot of Drexel Burnham, is **Humana**, whose PPO promises a lid on increases in employers' medical premiums. The Louisville company also has the highest return on equity in the industry. Slightly smaller than Humana is **National Medical Enterprises**, which launched a PPO in April.

Investors who are extra jittery about the future of acute-care hospitals should consider two chains recommended by John Hindelong and Charles Schaible of A.G. Becker Paribas. Patients or private insurers pay most of the bills at **Community Psychiatric Centers**, a San Francisco-based chain that also owns 44 kidney dialysis facilities. The company has one of the strongest balance sheets in the industry and a high price-earnings multiple on its stock. More reasonably priced is **Charter Medical** of Macon, Georgia, which now gets 40% of its revenue from psychiatric hospitals. Over the last five years the company's earnings per share have grown at a 46% annual clip.